Fund Manager: Economy Is Totally Fake, Deep Crash Coming

***by* BLOOMBERG | NOVEMBER 4, 2014**

Paul Singer's Elliott Management Corp. said optimism on U.S. growth is misguided as economic data understate inflation and overstate growth, and central bank policies of the past six years aren't sustainable.

The market turmoil in the first half of October may be a "coming attractions" for the next real crash that could turn into a "deep financial crisis" if investors lose confidence in the effectiveness of monetary stimulus, Elliott wrote in a third-quarter letter to investors, a copy of which was obtained by Bloomberg News.

"Nobody can predict how long governments can get away with fake growth, fake money, fake jobs, fake financial stability, fake inflation numbers and fake income growth," New York-based Elliott wrote. "When confidence is lost, that loss can be severe, sudden and simultaneous across a number of markets and sectors."

Six years of near-zero interest rates and three rounds of asset purchases by the Federal Reserve have fueled economic growth and helped U.S. stocks more than triple from their 2009 low when including dividends. The stock market has rebounded 8.3 percent through yesterday from a six-month low on Oct. 15, fueled by better-than-forecast economic data and improving earnings reports.

Republican Backer

The 70-year-old Singer, one of the biggest backers of Republican politicians, reiterated criticism that monetary policies won't create lasting growth. While the U.S. is doing better than the rest of the world, the acceleration in the second quarter only reversed a "terrible" first quarter and has yet to be sustained

in the remainder of the year, Elliott wrote.

“We do not think this optimism is warranted, and we think a lot of the data is cooked or misleading,” Elliott, which manages $25.4 billion and was founded by Singer in 1977, wrote. “A good deal of the economic and jobs growth since the crisis has been fake growth, with very little chance of being self-reinforcing and sustainable.”

Related: U.S. Deficit Decline to 2.8% of GDP Is Unprecedented Turn

Elliott said that the reported growth numbers are too high because the official inflation number is understating actual inflation by as much as 1 percent a year. That’s because economists focus on measures such as core inflation or make “hedonic adjustments” for improvements in the quality of consumer goods. Inflation is also distorted “by the increasing gap between the spending basket of the well-off and that of the middle class,” the firm said.

Bonds, Art

“The inflation that has infected asset prices is not to be ignored just because the middle-class spending bucket is not rising in price at the same rates as high-end real estate, stocks, bonds, art and other things that benefit from” quantitative easing, Elliott wrote.

Stephen Spruiell, a spokesman for Elliott, declined to comment on the letter.

The unemployment rate, at 5.9 percent in September, doesn’t reflect that the workforce participation rate is at a 35-year low, according to Elliott, and that full-time jobs have been replaced by part-time jobs, and high-paying jobs by relatively low-paying jobs. Real wages, the firm said, have been stagnant since the financial crisis.

The economy grew 2.3 percent in the year ended in September, compared with an average 2.9 percent advance in the four years before the past recession began, according to figures from the Commerce Department. It’s forecast to grow 2.2 percent this year and 3 percent in 2015, according to the median estimate of economists surveyed by Bloomberg last month.

Deficit Shrinks

Inflation, meanwhile, has been muted and government bonds rallied. Consumer prices over the past five years have grown 2.1 percent on average, and were up 1.7 percent in the 12 months through September, according to figures from the Labor Department. They are projected to rise 2 percent in 2015 and 2.2 percent in 2016, according to economists surveyed by Bloomberg last month.

Government bonds as measured by the Bank of America Merrill Lynch Treasury Index have rallied 26 percent in the past six years. The U.S. budget deficit has narrowed to the lowest level since 2008, marking the sharpest turnaround in the government’s fiscal position in at least 46 years. The shortfall of $483.4 billion in the 12 months ended Sept. 30 was 2.8 percent of the nation’s gross domestic product of $17.2 trillion over the same period, according to data compiled by Bloomberg using Commerce Department figures. The figure peaked at 10.1 percent of GDP in December 2009.

‘Generally Improved’

“Mortgage rates dropped, Treasury rates stayed low, and things generally improved,” said Brian Jacobsen, who helps oversee $232 billion as chief portfolio strategist at Wells Fargo Advantage Funds in Menomonee Falls, Wisconsin. “Was this due to the Fed? Not entirely, but probably at least partially.”

[Bill Gross](), in his second investment outlook since joining Janus Capital Group Inc., said yesterday that fiscal spending may be needed to fight the "growing possibility" of deflation, because central bank policies have pushed up only asset prices and not prices in the real economy.

Elliott, whose oldest fund has delivered compounded annual returns of 13.9 percent since inception, said that while central banks have lifted asset prices, there have been no "significant structural improvements" since the financial crisis that would allow the developed economies to grow faster.

"Our belief is that the global economy and financial system are in a kind of artificial stupor in which nobody (including ourselves) has a good picture of what the next environment will look like," the firm wrote.

The Economy Is So "Strong" It Just Cost Obama The Senate

***by* ZERO HEDGE | NOVEMBER 5, 2014**

Cognitive dissonance plaguing the mainstream media.

Based on the ridiculous, seasonally-adjusted data released day after day by the various US "Departments of Truth", also known as the BLS, the Census, the Dept of Commerce, UMichigan, ADP, the Conference Board and so on, the US economy is so strong and consumer confidence is so resurgent, America is on the verge of a second golden age.

Sadly, for Obama, and last night's epic rout for Democrats, **it was all a lie** - a lie perpetuated by a manipulated S&P500 which now hits daily record highs on unprecedented central bank liquidity injections which have now terminally disconnected the "markets" from the economy, and the welfare of the vast majority of the common "folk" – and said "folk" saw right through it.

Bloomberg's take is just one of many observations on the historic cognitive dissonance that is plaguing the mainstream media this morning, which has been furiously pumping up US confidence by pitching the endless array of "fake data" (to use Paul Singer's words), only to see it all blow up in its face today.

> **The economy was voters' most pressing concern as they cast their ballots in the midterm election, with seven of 10 rating conditions poor, preliminary exit polls showed.**
>
> More than five years after the recession ended, ordinary Americans still feel pinched. Wages and incomes haven't recovered even as corporate profits hit records, stocks have almost tripled and the nation's output of goods and services grew more than $1 trillion from its pre-recession peak.
>
> Obama's Democratic allies took the hit, with Republicans gaining a majority in the Senate for the first time during his presidency and adding seats in the House, which they have controlled for four years. Yet Republicans could hardly claim a mandate from yesterday's results, and they'll be judged on their ability to govern.

Irony #1: Bloomberg, which has been one of the many outlets spinning the "great recovery" is confused:

> The discontent simmered even as the economy showed signs of strengthening in the run-up to the election, posting its strongest six months of growth in more than a decade. Gross domestic product expanded at a 3.5 percent annualized rate in the three months that ended in September after a 4.6 percent gain in the second quarter, the best back-to-back showing since 2003.

Maybe, just maybe, the economy never really strengthened, and it was all even more of the same propaganda that has ordinary Americans finally seeing through the lies. Bloomberg at least admits that much: **"Most Americans haven't shared in the gains. Adjusted for inflation, the July median household income of $54,045 was $2,600 lower than in December 2007…**. Voters by 65-31 percent said the country is on the wrong track. That's 12 points more negative than two years ago and was the second-gloomiest exit-poll reading since 1990, trailing only the 2008 election, the preliminary numbers showed. Half of voters expect life to be worse for the next generation."

Irony #2: even as America is increasingly seeing through the left-right lies, and realizes that the GOP has no magic bullet to fix the economy, the vote last night was not for Republicans as much as against a broken status quo.

> Senator Bob Corker, a Tennessee Republican, attributed his party's gains to "disappointment and disillusionment with the administration." He added, "I don't think on the other end it's a major endorsement of the Republican Party, either."
>
> Fifty-eight percent of voters said they were dissatisfied or angry at the White House, according to the preliminary exit polls; 59 percent said the same about Republican congressional leaders.

Irony #3: nothing will change:

> Senator Ted Cruz, a Tea Party-backed Texas Republican, said this week that his colleagues must fight Obama at every turn. His priority, he told the Washington Post, is "looking at the abuse of power, the executive abuse, the regulatory abuse, the lawlessness that sadly has pervaded this administration."
>
> Cruz also wants to line up votes to dismantle Obama's health-care law, a mission that

> would require improbable two-thirds majorities in both chambers to overcome presidential vetoes.
>
> Some Republican leaders also say an all-out confrontation with Democrats is a one-way ticket back to the minority. Already, there are a few issues, most notably the Trans-Pacific Partnership trade deal, where both sides say there is opportunity for Obama to come together with Republicans.

The problem is that Obama, increasingly focused only on the golf course, will have none of it.

> Frustrated with gridlock in Congress, Obama declared earlier this year that he would use his executive power to circumvent lawmakers on climate change and the minimum wage paid to federal contractors, as well as on immigration. That didn't help his party yesterday and some, including Vice President Joe Biden, have signaled a willingness to compromise with Republicans.

The irony does not stop there, because the biggest beneficiary of the Obama administration and the split Congress so far has been the 1%, by way of the S&P 500 rising relentlessly in the fact of bad or good news. That rise continued overnight.

> U.S. equity-index futures rose, the dollar strengthened and precious metals fell. Standard & Poor's 500 Index futures advanced 0.4 percent at 10:03 a.m. in London, signaling the gauge will approach a record. The Bloomberg Dollar Spot Index climbed to its highest level since April 2009. The Stoxx Europe 600 Index jumped 1 percent.

Well, the economy may not get better but at least the rich will get a little richer as the charade continues.

But even a world full of ironies needs some humor, and it got it with this WSJ story, "GOP Senate Takeover Puts Fed on Hot Seat":

> Republicans' takeover of the U.S. Senate promises increased political turbulence for the Federal Reserve, which has already been under pressure from a GOP-controlled House.
>
> Financial executives say a GOP-led Senate would ratchet up congressional scrutiny of the central bank's interest-rate policies, as well as its regulatory duties as overseer of the nation's largest financial firms. Republicans haven't controlled the Senate since before the 2008 financial crisis and recession, which put a spotlight on the Fed and its powers.
>
> "If the Republicans take control of the Senate and thus have control of both the House and the Senate—two words for the Federal Reserve: Watch out," Camden Fine, president of the Independent Community Bankers of America, said before the Election Day results were final. His group represents the community-banking industry.

While we enjoy the humor that someone will dare to touch the goose that lays the golden market, but we wish to make a small correction: it's not two words. It's three: "**get to work.**" Because after a few days when the excitement and the drama wears off, the people will once again realize they have been fooled, the only winners are Wall Street, the wealthy and their political marionettes in D.C. As for everyone else, well there is 2016, and then 2018, and so on… because the lie must go on.

The Fake World: “Fake Growth, Fake Money, Fake Jobs, Fake Stability, Fake Inflation Numbers”

***by* ZERO HEDGE | NOVEMBER 4, 2014**

Nobody can predict how long governments can get away with fake growth

***Excerpted from Elliott Management’s Paul Singer letter to investors*,**

FAKING IT

Nobody knows when reality will overtake the rhetoric, lies, phony statistics, wishful thinking, fake prices and tiresome poseurs pretending to be world leaders. The situation is universal, a consequence of incompetent leaders and careless (or ignorant) citizenry. Global problems are continuing to mount, along with the risk that the consequences of years of bad policies and inept leadership compound (as sometimes happens) in a short window of time. Let us start by unpacking some current examples of fakery, and then try to explore the consequences.

Monetary policy.

Either out of ideology or incompetence, all major developed governments have given up (did they ever really try?) attempting to use solid, fundamental policies to create sustainable, strong growth in output, incomes, innovation, entrepreneurship and good jobs. The policies that are needed (in the areas of tax, regulatory, labor, education and training, energy, rule of law, and trade) are not unknown, nor are they too complicated for even the most simple-minded politician to understand. But in most developed countries, there is and has been complete policy paralysis on the growth-generation side, as elected officials have delegated the entirety of the task to central bankers.

For their part, the central bankers are proud and delighted to be providing the primary support for the global economy. Their training for this role took place in the decades before the 2008 financial crisis, when central bankers (led by “The Maestro,” Alan Greenspan) “deftly” headed off crisis after crisis. These policy responses “worked,” we were told, and they promised a new era of fine-tuning,

moderation in markets and complete control of the economy by central bankers. The words in quotes are meant to be ironic, of course, because in fact, the Federal Reserve Board's moves disguised hidden – but serious and real – future costs, which came due in 2008. The ensuing crisis introduced the term "moral hazard" (not meant to be ironic) into the mainstream, meaning that risks were taken by financial institutions and others seeking private reward, while the costs of the risks were borne primarily by the taxpayers. **Central bank manipulation of prices and risk taking has become the norm over the last six years, because it is so hard for investors to see the downside. QE and ZIRP have been "free," as far as most people are concerned, in terms of stability, asset price and economic growth, and economic recovery. "Free" in this context means devoid of future countervailing negative consequences.** Unfortunately, this particular magic bullet is illusory – the negative consequences are in the early stages of revealing themselves.

Among **the worst consequences of the delegation of responsibility from political leaders to central bankers has been the increasing arrogance of the latter group and their inability to understand the rapidly evolving nature of the world's major financial institutions**. Prior to the crisis, central bankers were unable to understand the risks that were building up in the global financial system and the economy. They did not see the 2008 collapse coming, nor did they perceive how fragile the system had become, or that the major financial institutions had become the largest and most leveraged hedge funds on earth.

This lapse was a catastrophic error, not just of execution but also of theory and structure. During the 2008 crisis, the central bankers (rightly) applied standard (more or less) responses to financial collapse (flooding the system with liquidity and reducing interest rates), which of course truncated the crisis and stabilized the system. But their inability to understand the financial system, or to take responsibility for their massive failures in causing/allowing the crisis to occur, has resulted in a seriously deficient economic recovery phase. **Central bankers do not understand that it was their tinkering, manipulation, bailouts and false confidence that encouraged and enabled the insanity that led to the fragility and collapse.** Partially as a result of that misunderstanding, the developed world has doubled down on the same policies, feeding the central bankers' supreme self-confidence. Political leaders have been content to stand aside and watch the central bankers do their seemingly magical and magnificent work.

The believers in the wisdom of this central-banker-centric economic world have been crowing and gloating that those (like us) who have raised concerns about the risks posed by the post-crisis, monetary-dominated policy mix (inflation, distortions, growing inequality, lower growth) are just "wrong" and should apologize for a "massive error." This, shall we say,**"Krugmanization" of a substantial portion of the economics profession and punditocracy is in its triumphalist phase, and whether its smug non-stop "victory lap" ultimately represents an embarrassing high-water mark is for subsequent events to reveal.**

However, let us look at the policies that have been implemented post-crisis (in the absence of the kind of solid pro-growth policies that we and others have been advocating) and compare them to the policies

that were in place during the run-up to the 2008 crisis.

> ***Pre-crisis****, the Fed funds rate was 1% for 2-1/2 years. There was no asset buying by the central bank (QE), but the persistently low Fed funds rate fueled bubbles in leverage, real estate and structured products. The balance sheets and derivatives books of financial institutions went from crazy to colossally insane.*

> ***Following the crisis****, the Fed funds rate has been effectively zero for six years, and QE has put several trillion dollars of government and mortgage debt on the books of the world's major central banks. Indeed, a substantial portion of government spending in the past six years has been "financed" by QE. If the gibberish that passes for explanations of why this is not just money printing makes sense to you, then please give us a call so we can be educated. The explanation makes no sense to us.*

ZIRP has allowed insolvent corporations to issue debt at almost no premium to government bond rates. **Companies that should be shuttered or taken over and chopped up are instead able to pursue projects that should never have seen the light of day, and to create fake demand that essentially borrows growth (and jobs) from the future.**

A good deal of the economic and jobs growth post-crisis is false growth, with little chance of being sustainable and self-reinforcing. It is based on fake money conjured by the Fed to buy assets at fake prices. What happens when interest rates are normalized and QE stops (and reverses) globally is a question that nobody wants to contemplate. **The financial system is fragile, still ultra-leveraged and reliant upon a continuation of superlow interest rates. Thus, the appearance of stability and low volatility is also illusory.**

Government economic data.

Some of the most important government data is unreliable, starting with inflation. Reported real GDP growth has been in the 2% annualized range for the last few years. The 4% annualized real growth rate reported for the second quarter of 2014 only reversed the terrible first quarter numbers, so year-over-year growth was still only in the 2% range for the twelve months ended June 30, 2014. Only if third and fourth quarter real GDP growth reaches 3% or higher, and only if that rate persists next year, will it be fair to say that the U.S. economy has finally recovered from the crisis (six tough years later).

But regardless of the purported results for the rest of 2014 and into 2015, all of the reported growth numbers are too high, because the official inflation number is too low. **Over a long period of time, these figures have become politicized, always in the direction of under-reporting inflation.** Constant repetition has resulted in most policymakers and economists now just accepting the adjustments and tricks that have become part of the reporting culture. From the notion that there is "core" and "non-core" inflation; to ignoring house prices and using "rental equivalence"; to "hedonic adjustments" according to which, if your computer is "better" than last year's, then you should subtract an amount from the actual price every year to reflect that improvement, even though it is subjective and not really quantifiable; to a handful of other nonsensical adjustments, inflation is understated. **Inflation is also distorted by the increasing gap between the spending basket of the well-off and that of the middle class** (check out London, Manhattan, Aspen and East Hampton real estate prices, as well as high-end art prices, to see what the leading edge of hyperinflation could look like).

Said differently, inflation is the degradation of the value of money. Money has no meaning beyond the

value of the real things for which it can be exchanged. The inventions and tools of modern finance have made things look really complicated, but stripping inflation to its essence is critical to understanding what is real and what is false. The inflation that has infected asset prices is not to be ignored just because the middleclass spending bucket is not rising in price at the same rates as high-end real estate, stocks, bonds, art and other things that benefit from QE and ZIRP. **Money is losing value in those areas. This is inflation, plain and simple. If and when the situation gets to be Argentina-like, with generalized increases across the entire spending spectrum, it will be clear to everyone.** In the meantime, sadly, policymakers do not recognize the reality of the peculiar and sectoral inflation, in some cases massive and growing, that has been caused by money printing and bad policy.

Even apart from rising prices in high-end goods, all of this suggests that **CPI inflation is being understated by some unknowable amount, which we estimate is between 1/2% and 1% per year**. This is a big difference in a 2% or 2-1/2% per year reported real GDP growth environment. Middle class citizens who are paying more at the supermarket and for college tuition and for many other goods and services feel that inflation is higher than reported, but they lack access to reliable data. The well-off think that it is their exquisite good choices that enable them to sell their overpriced $10 million co-op apartment and buy a $20 million overpriced Hamptons beach home. Neither group is coming to grips with the insidious and tricky nature of modern inflation, and the government just uses its tone of complete confidence to ignore what citizens see with their own eyes.

Unemployment figures are also a source of faulty or misleading data. The headline currently reported unemployment rate of 5.9% is deeply misleading. A 35-year low in the workforce participation rate, a policy-driven transition from full-time to part-time jobs, and the transition from high-paying jobs to relatively low-paying service jobs, all combine to make the headline rate a poor measure of employment health. Support for our statement is provided by the data on real wages, which have been stagnant during the entire post-crisis period. **These figures for trends in real wages avoid the distortions we have described above, and are consonant with the polling numbers which show that Americans believe their country is on the wrong track and that the future prospects for themselves and their children are poor.**

Deleveraging.

The 16th Geneva Report on the World Economy (published in September of this year by the Centre for Economic Policy Research) says that the total burden of global non-financial debt, private and public, has risen from 60% of national income in 2001 to almost 200% after the crisis in 2009 and to 215% in 2013. **Contrary to widely held beliefs, the world's leading governments and financial institutions have not yet begun to de-lever, and the global debt-to-GDP ratio is still growing to record highs, even before taking into account entitlement programs.**

* * *

Nobody can predict how long governments can get away with fake growth, fake money, fake financial stability, fake jobs, fake inflation numbers and fake income growth. Our feeling is that confidence, especially when it is unjustified, is quite a thin veneer. When confidence is lost, that loss can be severe, sudden and simultaneous across a number of markets and sectors.